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SUPREME COURT, U. S.

No. 311

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In the Supreme Court of the United States

OCTOBER TERM, 1961

SAMUEL B. FRANKLIN & CO.,
PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. 1-13) is reported at 290 F. 2d 719. The findings and opinion of the Securities and Exchange Commission are set forth in Securities Exchange Act Release No. 5915 and appear at R. 26-38.

JURISDICTION

The judgment of the Court of Appeals affirming the order of the Securities and Exchange Commis-

sion was entered on May 1, 1961 (Pet. App. 13-14), and rehearing was denied on June 3, 1961 (R. 74). The petition for a writ of certiorari was filed on August 14, 1961. This Court has jurisdiction under Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y, and 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Securities and Exchange Commission properly sustained disciplinary action by a national securities association against a member for violating its rules by buying from and selling to its customers securities at unfair prices, on the basis of evidence that in many instances and without justification his prices varied from current market prices by more than twenty percent.

STATUTE INVOLVED

The pertinent provisions of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3, 52 Stat. 1070, the so-called Maloney Act, are set forth in the Appendix, *infra*, pp. 8 to 11.

STATEMENT

The petitioner is a member of the National Association of Securities Dealers ("NASD"), a securities association registered under Section 15A of the Securities Exchange Act of 1934.

Subsection (b)(7) of Section 15A requires that a registered association must have rules designed, *inter alia*,

> "* * * to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market * * *."

Accordingly, the NASD has adopted Rules of Fair Practice. The petitioner was charged with violating two of these rules during the period of January through May, 1956 (R. 4).[1] One of these (Article III, Section 1) requires members in the conduct of their business to observe high standards of commercial honor and just and equitable principles of trade, and has been interpreted by the NASD as prohibiting its members from entering "into any transaction with a customer in any security at a price not reasonably related to the current market price of the security."[2] The other NASD rule allegedly violated by petitioner (Article III, Section 4) provides that where a member buys for his own account from his customer or sells for his own account to his customer, the price must be fair, taking into consideration all relevant circumstances, including market conditions, the expense involved, and the fact that the member is entitled to a profit.

The disciplinary proceedings against the petitioner were instituted pursuant to rules of the NASD re-

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[1] The applicable rules are set forth in the Appendix, *infra*, pp. 11 to 12.

[2] NASD Manual G-3.

quired by subsections (b)(8) and (9) of Section 15A of the Securities and Exchange Act to the effect that a registered association's rules must "provide that its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or any other fitting penalty for any violation of its rules" and "provide a fair and orderly procedure with respect to the disciplining of members * * *." On December 11, 1956, the local District Committee of the NASD filed its complaint against the petitioner. After a hearing before a subcommittee, it was found that violations of the foregoing rules had been committed by the petitioner. The District Committee censured the petitioner, fined him $1,000, and assessed costs of $773.80. On appeal by the petitioner to the Board of Governors of the NASD, the decision of the District Committee was affirmed and additional costs of the appeal in the amount of $153.29 were assessed.

On review by the Securities and Exchange Commission pursuant to subsections (g) and (h) of Section 15A of the Securities Exchange Act, the Commission found "that, as found by the NASD, applicant sold and purchased securities at prices which were not fair under all the relevant circumstances and not reasonably related to current market prices, and that such conduct was inconsistent with just and equitable principles of trade and violated Sections 1 and 4 of Article III of the NASD rules," and stated "that we cannot find that the fine, censure and costs imposed by the NASD are excessive or oppressive, having due regard to the public interest" (R. 33-34). Accordingly, the Commission dismissed the review proceedings (R. 35). Thereafter, the Commission

denied the petitioner's request for a rehearing (R. 41-42) and the petitioner sought review of the Commission's order in the Court of Appeals.[3]

As noted by the court below, the basic facts are not is dispute (Pet. App. 11). In 260 of petitioner's 731 sales transactions during the period January 1 through May 13, 1956, petitioner's mark-up over the current market prices exceeded 20 percent—in 99 instances being between 30 percent and 62 percent. In 20 purchases during this same period the mark-down exceeded 20 percent; in 6 of these it ranged from 30 percent to 37 percent (R. 30).

ARGUMENT

The petition presents no question of importance and the decision of the court below was clearly correct.

Essentially the petitioner appears to argue that a policy limiting mark-ups or mark-downs to five percent with respect to low-priced stocks is unfair. As both the Commission and the court below made clear, however, the disciplinary action against the petitioner was upheld on the basis of mark-ups and

---

[3] Under Section 25(a) of the Securities Exchange Act, 15 U.S.C. 78y, review of an order of the Commission may be had in a court of appeals by the filing of a petition to review "within sixty days after the entry of such order." The petition for review was filed in the court of appeals within 60 days of the Commission's order denying the petition for rehearing, but after 60 days had elapsed from the date of the Commission's original order. The Commission supported the petitioner's right to review in the court below, urging the court not to follow its previous holdings under comparable statutory provisions to the effect that the petition must be filed within 60 days of the original order.

mark-downs that were greater than 20 percent (R. 33; Pet. App. 12-13). The Commission also made clear that it took into consideration such additional circumstances as the riskless character of many of the petitioner's transactions (R. 32).[4] The Commission also considered the petitioner's failure to show "any special circumstances, such as unusual expenses in connection with particular transactions, extraordinary services rendered to customers, or acquisition of inventory at special concessions, to warrant the mark-ups charged" (R. 33).

Accordingly, the petitioner's charges, based on off-the-record data that in certain circumstances customers of stock exchange firms who act as their brokers might pay more than 5 percent in commissions and other expenses, are wholly irrelevant. In the light of the high spreads here—between 20 and 62 percent—the Commission properly found that these were "clearly excessive by any reasonable criteria" (R. 32). As the Commission stated early in its history:

> "Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. It is neither fair dealing, nor in accordance with

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[4] *Cf. Hughes & Co.* v. *Securities and Exchange Commission*, 139 F. 2d 434, 436 (C.A. 2):

> "In addition, most of the transactions involved little or no risk for petitioner, because an order was usually confirmed before it bought the securities that it was selling."

such standards, to exploit trust and ignorance for profits far higher than might be realized from an informed customer." [5]

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

D COX,
ARCHIBALr *General.*
Solicitor

PETER DAMMANN,
General Counsel,

DAVID FERBER,
Assistant General Counsel,
Securities and Exchange Commission.

September, 1961.

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[5] *Duker & Duker,* 6 S.E.C. 386, 388-389. In that case the failure to disclose unreasonable profits was held to be fraudulent. Such holdings have been affirmed in appellate courts. See *Hughes & Co.* v. *Securities and Exchange Commission,* 139 F. 2d 434 (C.A. 2), and *Weber* v. *Securities and Exchange Commission,* 222 F. 2d 822 (C.A. 2). In the present case there is involved only the question whether the NASD's Rules of Fair Practice have been violated.

APPENDIX

Pertinent provisions of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3, 52 Stat. 1070 *et seq.*, are:

> (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b) * * *, under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:
>
> * * * *
>
> (b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—
>
> * * * *
>
> (7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges;

(8) the rules of the association provide that its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules;

(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and the denial of membership to any broker or dealer seeking membership therein. In any proceeding to determine whether any member shall be disciplined, such rules shall require that specific charges be brought; that such member shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include (A) a statement setting forth any act or practice in which such member may be found to have engaged, or which such member may be found to have omitted, (B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation, (C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade, and (D) a statement setting forth the penalty imposed. In any proceeding to determine whether a broker or dealer shall be denied membership, such rules shall provide that the broker or dealer shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial

which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial is based;

* * * *

(g) If any registered securities association (whether national or affiliated) shall take any disciplinary action against any member thereof, or shall deny admission to any broker or dealer seeking membership therein, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within sixty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (h).

(h)(1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant, shall (A) find that such member has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and (B) shall determine that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the pro-

ceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A) of this paragraph, or if the Commission shall determine that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that ~~such act~~ as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

* * * *

Pertinent provisions of Article III of the Rules of Fair Practice of the National Association of Securities Dealers are:

Section 1. A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

* * * *

Section 4. In "over-the-counter" transactions, whether in "listed" or "unlisted" securities, if

a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor.

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Petitioner's Reply to Brief for the Securities & Exchange Commission in Opposition.

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